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Keynote Speech delivered by Mr. Jamal Abbas Zaidi, CEO, IIRA

I am honored to be here to represent IIRA. I am also honored to be here to talk to you, very briefly, about the importance of ratings in today's world.

Ratings offer significant benefits for institutional investors controlling capital available for economic development. Indeed, credit ratings were invented as a service to investors by John Moody in 1909 as part of his effort to enhance the value of the statistical information he was publishing about railroads and canal companies. Over time, ratings have come to serve a key role in efficient capital markets. They ensure an orderly market with effective allocation of capital among competing uses. In concept, ratings are very simple: Rating is a symbol denoting relative quality of debt instruments and investments; it is an opinion or prediction regarding the likelihood, that a debt or financing in Islamic industry, will be serviced in compliance with its terms, whatever they might be. The basis for the authority of rating agencies is acceptance of their rating judgments and research, by investors controlling capital available for economic development.

Institutional investors and lenders, of course, must have the analytical capacity to make such determinations on their own. It lies at the heart of the investment decision process because it must govern policy infrastructure and is key to development of the framework for decisions on alternative investment opportunities. Without a sound investment policy, decisions are taken on an ad hoc basis, with the likely result of a less-than-optimum portfolio, or even a dangerous portfolio.

Consequently, investors begin with a well-defined set of investment objectives. In most cases, they begin with safety of principal and profit as the most important consideration. Typically, this is defined in terms of ratings. Investors in Islamic instruments would also like to be assured of Shari'a Quality of an investment. An acceptable rating level is set as a floor for potential investment. Investors are aware of historical default levels associated with various rating categories. This enables them to define acceptable quality levels for their portfolio in terms of independent ratings. The investor may set a floor by informing investment bankers he will only buy securities rated BBB or better, or AA or better. Ratings are thus, first-and-foremost, a tool for investors with rating criteria an integral part of the process for determining whether a proposed investment qualifies for consideration.

Investors are familiar with the scope of fundamental analysis as employed by the rating agencies. Rating agency analysts are highly skilled, well-trained and experienced individuals. Since rating agencies rate a large portfolio of institutions and instruments in a given market, the analysts are in continual contact with the executives of all significant companies in a given industry and know what is happening. Investor analytical teams are rarely able to do this. Moreover, by virtue of rating agencies' special position in the market, issuers are often prepared to share detailed information with rating agency analysts on a confidential basis, recognizing it is in their best interest to achieve the highest rating possible. This information is incorporated in the rating decision, although

not explicitly published. The result is better information for the market and for the investor.

Further, the rating itself represents a higher level of transparency and additional information content for the market. In my meetings with the market leaders, I have come across comments that “they are in process of re-organizing, or re-structuring, or re-capitalizing or it is not legally required and therefore they are not ready for rating”. In developed markets, the absence of a rating is usually construed by conservative investors as an indication that there are credit problems with an issue or issuer. This may not be necessarily universally true, but it is an appropriate assumption. The ratings constitute a quality framework for the market. They facilitate investor comparison and selection of investment alternatives because the rating agency, with its fundamental approach and access to information, provides ratings that validly compare and contrast the strengths of different organizations.

This quality framework has another, equally important, advantage for institutional investors and issuers. Without this objective framework, developed by an agency without a vested interest in transactions or any conflicts of interest, pricing is an *ad hoc* exercise perpetrated by investment bankers. The risk premium on an issue may constitute appropriate compensation, but it is far more likely to be set to the advantage of the investors or issuer depending on the supply and demand for credit. With a rating framework, the underwriter must price according to similarly rated issues in the market - where the broader market has determined the correct yields for that rating category through many actual transactions. This forces rational pricing to the advantage of the investor (and issuers).

In addition to these basic issues of information content and rational pricing, rating agencies play a role in efficiency and cost substitution for institutional investors. Access to the analysis, with its informed process, greatly enhances the work of the analyst working for the institutional investor. Investors consult with rating agencies to test their assumptions and expectations, thus speeding and strengthening their own analysis. Finally, investors in many cases, use the full array of rating agency products and services in a way that allows them to maintain smaller, lower cost analytical teams on their own premises.

It is our expectation, borne out by the explosive growth of the rating industry from three providers in 1975 to more than sixty today, that investors and regulators in all financial markets will eventually rely on credit or investment quality ratings. In many regional markets the domestic rating agencies apart from Global Rating Agencies are contributing to development of capital markets. The success of the domestic agencies is based on the use of the same analytical tools as used by GCRA's, supplemented by superior local knowledge about reputation and track record of issuers. Basel II reinforces this expectation with its encouragement to banks to rely on External Credit Assessment Institutions. This is true because of the clearly defined benefits associated with bond and Sukuks ratings for investors and issuers (and intermediaries). The keys to these benefits are comprehensive, independent and professional analysis based on consistent and rigorous practices of the agencies, and absolute objectivity which can only be achieved in the absence of conflicts of interest and undue influence from parties external to the rating

agency and its Rating Committee. The Islamic International Rating Agency was established to afford these benefits and advantages to participants in the capital and money markets of Islamic countries.

Thank you for this opportunity to talk a bit about ratings. We should encourage all market participants to use ratings in their investment decisions.

N.B. Islamic International Rating Agency was given the Best Islamic Rating Agency Award at this event